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C O N F I D E N T I A L SECTION 01 OF 03 BASRAH 000056

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SUBJECT: BASRA: BP CONFIDENT ABOUT RUMAILA OIL DEAL, PARTNERSHIP WITH
CNPC

REF: BAGHDAD 2389, BAGHDAD 2686

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CLASSIFIED BY: John Naland, PRT Team Leader, PRT Basra, US State
Department.

REASON: 1.4 (b), (e)

[1](#)1. (U) This is a Basra PRT reporting cable.

[1](#)2. (C) Summary. In an October 1 meeting with PRT Econoffs, BP Iraq Chief Operating Officer David Campbell (strictly protect) expressed confidence that BP and its China National Petroleum Corporation (CNPC) partner would soon finalize a contract with the Ministry of Oil (MOO) to increase production at the Basra Province Rumaila field. (Note: On October 8, the MOO initialed this contract, which will now be referred to the cabinet for final approval. End note.) He said that the deal could gain cabinet approval within a few weeks, before the January 2010 elections, and possibly even before the December second oil/gas round. Campbell insisted that BP/CNPC can make money on the deal, despite what analysts widely consider to be an unprofitable, \$2 per barrel production fee, on the strength of sharply increased production. He said that the contract structure had an advantage in that fees are fixed irrespective of the world price for oil. He also said that BP would have full management control. Campbell had high praise for CNPC, and said that BP sought a partnership with them to share investment risk and to take advantage of CNPC's current experience in Iraq. Campbell said that CNPC had gained "undeserved" negative publicity in its management of the nearby Ahdab field in Wasit Province. He admitted that while BP/CNPC can make a profit on the Rumaila field, its acceptance of this low production fee was also "an attempt to get a foot in door" in Iraq, and to re-establish its historic presence in this region. Campbell said that BP is still working on a "corporate social responsibility" strategy and how to deal with the local populace, and to ensure that expectations are kept in check. End summary.

Background on BP/CNPC deal

[1](#)3. (SBU) The BP-led service contract for Rumaila was the only deal that emerged from the MOO's first oil/gas June auction. While most oil firms at the auction balked at Iraq's stiff payment terms, BP and CNPC accepted the MOO's \$2 per barrel remuneration fee to win the Rumaila contract. The MOO will offer 15 other oil or gas field groups in a second bidding round in December. The BP-led consortium plans to increase Rumaila's production, Iraq's largest producing oil field, from around 1 million barrels per day (mb/d) - almost half of Iraq's total output of 2.5 mb/d) - to 2.85 mb/d within the first six years of the \$27 billion, 20-year contract. BP-CNPC-GOI shares will be held at 38%, 37%, and 25%, respectively. BP/CNPC is working with the current Rumaila operator, Iraq's state-owned South Oil

Company (SOC) to set up a dedicated operating company, relying heavily on Iraqi manpower, with a small team of BP and CNPC managerial and technical staff.

Insists that Rumaila can be profitable

14. (SBU) Campbell insisted that BP/CNPC can make money, largely due to sharply increased production. "Margin is admittedly small, but we can make a profit." He said that Rumaila, presently the fifth largest field in world in terms of production, when up and running at 2.85 mb/d will become the number two producing field in the world, after the Ghawar field in Saudi Arabia, which produces around 5.1 mb/d.

15. (C) Campbell said that while a production sharing agreement (whereby the GOI would have awarded the execution of exploration and production activities to BP/CNPC, and BP/CNPC would have received a percentage of production, instead of the fixed fee per barrel it will be receiving) was preferable, BP views the per-barrel fee contract structure as having an advantage of its own in that fees are fixed irrespective of the world price for oil. He said that this lessens downside risk, and "it is good to have some of this type of revenue in a company's portfolio." On the perennial concern of allegedly high rates of oil theft at SOC, he said that BP is concerned about this, but he did not discuss the issue further.

Praises for CNPC partner

16. (C) Campbell expressed satisfaction with BP's prospective partnership with the Chinese oil giant. He said that BP's original objectives for teaming with CNPC were to share some of the investment risk and to take advantage of CNPC's experience in Iraq. (Note: CNPC currently operates the Ahdab oil field in nearby Wasit Province. End note.) Campbell also said that BP views CNPC as a potential strategic partner for other projects

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in Iraq and elsewhere in the world. He said that BP views CNPC's operational experience in Iraq, and particularly its capital equipment vertical supply chain as a key advantage, the latter which BP plans to use (and in which he said BP has no such ability in Iraq). "Supply chain management is critical: I am less worried about any problems related to production, SOC workers, or the GOI bureaucracy than I am about getting equipment to fields on time," and in this area he said that CNPC will help. Campbell also said that CNPC has an altogether different view of risk than BP and many western firms do, and provides a "refreshing outlook" on all areas of doing business in Iraq. He said that senior BP executives had visited CNPC's China operations, and were favorably impressed, including with its Daqing oil field operations that produces about 1 mb/d, the sixth largest field in the world.

17. (C) Campbell was adamant about what he said was an "undeserved" negative reputation that CNPC has gained as a result of its Ahdab field operation in nearby Wasit Province. Campbell said he and his BP colleagues had closely researched CNPC's work there (as part of its due diligence) and concluded that the negative reputation appeared to originate entirely from an "unwarranted and unfair" September New York Times article. He said that CNPC contends that it complied "100 percent" with every aspect of the CNPC-GOI agreement, including complete cooperation with the provincial council, governor and other groups. He said that while the article was unfair, a certain "Asian viewpoint" and way of doing business in Iraq might at times cause some miscommunication with Iraqis, and in these areas BP might help CNPC.

Ownership and management structure

¶18. (SBU) Campbell confirmed recent press reports that BP recently gave CNPC a larger equity share. The new stakes cuts BP's share to 38% from an initial 50%, raised CNPC's share to 37% from 25%, and maintains the GOI's portion at 25%. Campbell confirmed media reports that the GOI will pay nothing upfront. He also said that BP will have full management control, with "no GOI interference." He said that the concept of the Field Operating Division (FOD), conceived by the MOO to keep the most prized fields of Iraq in the hands of Iraq's national operating companies, has been dropped, and that a "Rumalia Operations Organization," run by BP, will operate the field, to include exploration, development and production. At the same time, he admitted that a complete definition of roles and responsibilities between and among the three entities isn't entirely defined yet, beyond BP being the primary entity.

BP "wants to show the world that this deal can work"

¶19. (SBU) Campbell admitted that BP faces real risks, citing what he acknowledged was a low production fee, as well as the always present legal and political risks in Iraq. "It will not be easy, but these kinds of risks are in the nature of the oil business, and sometimes the public does not understand this." At the same time, he contended that the deal was potentially vast and lucrative, at \$27 billion over 20 years. Campbell acknowledged that BP's own CEO had publicly admitted that accepting the \$2 per barrel fee was part of the overall goal of "getting a foot in the door [of Iraq]." He said that BP "needs to re-establish" its presence in this region, given that this is where the company got its start. (Note: British Petroleum began its operations in 1908 in present day Iran. End note.) He said that nowadays, BP's activities and reserves are almost exclusively located in Alaska and the North Sea, and "we need to be in more regions of the world." But he again stated that BP can make money under these tight financial conditions, and the deal stands up on its own without these non-financial considerations.

Hearts and minds

¶10. (SBU) Campbell said that BP is still working on its "corporate social responsibility" strategy and dealing with the local populace and government, and sought our opinion about strategies and ideas. We agreed that a limited scope and managing what might be too high expectations are important. Campbell said that BP planned to have an open dialogue with the provincial government, local sheikhs, worker groups, and other stakeholders. He also confirmed that BP/CNPC does not anticipate significant employment increases, and that this fact will have to be understood by the local populace. Instead, BP and CNPC will "sprinkle" a few of its senior management and

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technical staff within the ranks of SOC, and that most work will come from the existing 20,000-odd SOC employee base.

¶11. (C) Campbell said that BP plans to have a small headquarters in Basra, and will construct a compound for offices and accommodations. He said that BP is will also acquire a turbo prop to plane reach nearby oil fields from Basra airport, and is negotiating with Kuwait-based Arab Wings to secure charter rights to transport personnel into and out of Basra.
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